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HOUSE OF REPRESENTATIVES

REPORT
No. 97-831

COMPLETED

TAX TREATMENT OF CERTAIN MONEY PURCHASE PENSION PLANS

SEPTEMBER 16, 1982.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. ROSTENKOWSKI, from the Committee on Ways and Means, submitted the following

REPORT

[To accompany H.R. 4948]

[Including cost estimate of the Congressional Budget Office]

The Committee on Ways and Means, to whom was referred the bill (H.R. 4948) to amend the Internal Revenue Code of 1954 to provide for the application of cash or deferred arrangement rules to money purchase plans, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment (stated in terms of the page and line numbers of the introduced bill) is as follows:

Page 4, line 21, before the period insert ", and section 135(c)(2) of the Revenue Act of 1978 shall apply in respect of such a contribution under any pension plan".

I. SUMMARY

The Employee Retirement Income Security Act of 1974 (ERISA) provided that amounts deferred by an employee pursuant to a cash or deferred arrangement or a salary reduction arrangement under a tax-qualified profit-sharing, stock bonus or money purchase pension plan are excluded from the employee's income if (1) the plan was in existence on June 27, 1974, and (2) the applicable requirements of prior law were satisfied. This tax treatment for existing plans was preserved, pending study by the Congress of the appropriate treatment for cash or deferred and salary reduction arrangements.

Under the Revenue Act of 1978, amounts deferred by an employee after 1979 pursuant to a cash or deferred or salary reduction arrangement under a tax-qualified profit-sharing or stock bonus plan

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are excluded from the employee's income only if certain requirements added by the Act are met. No rules were provided by the 1978 Act for amounts deferred pursuant to similar salary reduction arrangements under a money purchase pension plan.

Under the bill, amounts deferred by an employee pursuant to a salary reduction arrangement under a money purchase pension plan will be excluded from the employee's income if the plan was in existence on June 27, 1974, and contributions by employees and the employer do not exceed the levels permitted under the plan's contribution formula on that date. In addition, with respect to years beginning after December 31, 1980, the plan must satisfy rules added by the 1978 Revenue Act with respect to employee participation and prohibited discrimination in favor of officers, shareholders, or highly compensated employees. The bill will apply to money purchase pension plans maintained by taxable employers or tax-exempt organizations. The bill generally will apply for plan years beginning after 1980, and to contributions made after that date. A transition rule is provided for contributions made after 1979 and before 1981.

II. EXPLANATION OF THE BILL

Present Law

In general

A money purchase pension plan is a defined contribution plan under which each participant's pension benefit is based solely on the balance of the participant's account, consisting of contributions, income, gain, expenses, and losses. Profit-sharing plans are also defined contribution plans.

Under a profit-sharing plan, or under a money purchase pension plan with a salary reduction arrangement, the employer gives an employee the choice of (1) receiving a specified amount in cash as current compensation or (2) having that amount contributed by the employer to the plan.

In December 1972, the Internal Revenue Service issued proposed regulations which called into question the tax treatment of amounts contributed to qualified plans pursuant to such salary reduction arrangements. (These proposed regulations were withdrawn in July 1978). Under the rules in effect at the time of the proposal, an employee generally was not taxed currently on amounts the employee chose to have contributed pursuant to a salary reduction arrangement. Under the proposed regulations, amounts contributed to a plan by the employer due to the election of the employee would be included in the employee's income.

Freeze on tax treatment

In order to allow time for Congressional study of this area, ERISA provided that the tax treatment of employer contributions under cash or deferred or other salary reduction arrangements in existence on June 27, 1974 was to be governed under the law as it was applied prior to January 1, 1972. Accordingly, the employer contributions were not includible in the income of covered employees, provided the plans satisfied the requirements of pre-1972 law

and otherwise complied with the tax-qualification rules. Under ERISA, this freeze in tax treatment was continued through 1976, or (if later) until regulations were issued in final form which would change the pre-1972 administration of the law. The freeze was subsequently extended through 1979.

Revenue Act of 1978

The Revenue Act of 1978 provided rules for new and old profit-sharing plans with cash or deferred arrangements. The new rules, which also apply to stock bonus plans, are effective for plan years beginning after 1979. For years beginning before 1980, the tax treatment under a plan in existence on June 27, 1974, is determined under prior law. No new rules were provided by the 1978 act for salary reduction arrangements under money purchase pension plans.

Reasons for Change

Many tax-exempt organizations have money purchase pension plans with a salary reduction feature. Because these organizations are generally precluded from adopting profit-sharing plans or stock bonus plans, they would like to continue in existence these money purchase pension plans. Profit-sharing plans and stock bonus plans, which are generally available to, and adopted by, taxable employers, permit a cash or deferred option which is similar to a salary reduction arrangement.

Explanation of Provisions

The bill revises the tax-qualification rules to permit a qualified money purchase pension plan which was in existence on June 27, 1974, and which provided for a salary reduction arrangement on that date, to continue the arrangement after 1979. However, this revision to the tax-qualification rules will apply only to those money purchase pension plans under which employer and employee contributions may not exceed the limits (e.g. the percentage of pay) provided under the plan's contribution formula on June 27, 1974.

In addition, for plan years beginning after December 31, 1980 a salary reduction arrangement under a money purchase pension plan must meet the special tax-qualification rules for cash or deferred arrangements added by the 1978 Revenue Act with respect to employee eligibility to participate in the arrangement and to prohibited discrimination in favor of employees who are officers, shareholders, or highly compensated. These rules presently apply to cash or deferred arrangements under qualified profit-sharing or stock bonus plans.

The provisions of the bill apply to salary reduction arrangements under money purchase pension plans of taxable employers and tax-exempt organizations.

Effective Date

The bill generally will apply for plan years beginning after December 31, 1980, and to contributions made after that date. A tran-

sition rule is provided for plan years and contributions made after 1979, and before the beginning of the first plan year beginning after 1980.

III. EFFECT OF THE BILL ON THE BUDGET AND VOTE OF THE COMMITTEE REPORTING THE BILL

Budget effects

In compliance with clause 7 of Rule XIII of the Rules of the House of Representatives, the following statement is made about the effect on the budget of this bill, H.R. 4948. The committee estimates that the provisions contained in the bill, H.R. 4948, as amended, will have a negligible effect on budget receipts.

The Treasury Department agrees with this statement.

Vote of the committee

In compliance with clause 2(l)(2)(B) of Rule XI of the Rules of the House of Representatives, the following statement is made about the vote of the committee on the motion to report the bill, as amended. The bill, H.R. 4948, as amended, was ordered favorably reported by voice vote.

IV. OTHER MATTERS TO BE DISCUSSED UNDER HOUSE RULES

In compliance with clauses 3(l)(3) and 2(l)(4) of Rule XI of the Rules of the House of Representatives, the following statements are made with respect to the committee action on H.R. 4948, as amended.

Oversight findings

With respect to subdivision (A) of clause 2(l)(3) (relating to oversight findings), the committee advises that it was as a result of the committee's oversight activities with respect to salary reduction arrangements under money purchase pension plans that the committee concluded that it is appropriate to enact the provisions contained in the bill.

The Subcommittee on Select Revenue Measures held a hearing on the bill on June 14, 1982, and approved the bill, with amendments, by voice vote on July 12, 1983. A subcommittee report was transmitted to the full committee on September 10, 1982.

New budget authority and tax expenditures

With respect to subdivision (B) of clause 2(l)(3), after consultation with the Director of the Congressional Budget Office, the committee states that the changes made to existing law by this bill involve no new budget authority or new or increased tax expenditures.

Consultation with congressional budget officials on budget estimates

With respect to subdivision (C) of clause 2(l)(3), the committee advises that the Director of the Congressional Budget Office has examined the committee's budget estimates (as indicated in part II of this report) and submitted the following statement:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, D.C.

Hon. DAN ROSTENKOWSKI,
Chairman, Committee on Ways and Means, U.S. House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: In accordance with the Budget Act, the Congressional Budget Office has examined H.R. 4948, Extension of Cash and Deferred Plan Rules to Salary Reduction Arrangements under Money Purchase Pension Plans. The provisions of the bill apply to salary reduction arrangements under money-purchase pension plans of taxable employers and tax-exempt organizations.

This bill does not provide any new budget authority or any new or increased tax expenditures.

In accordance with Section 403 of the Budget Act, the Congressional Budget Office estimates that the bill will have a negligible effect on budget receipts.

Sincerely,

RAYMOND C. SCHEPPACH
For Alice M. Rivlin, (Director).

Oversight by Committee on Government Operations

With respect to subdivision (D) of Clause 2 (1) (3), the committee advises that no oversight findings or recommendations have been submitted to the committee to the committee by the Committee on Government Operations regarding the subject matter of this bill.

Inflationary impact

In compliance with clause 2 (1) (4), the committee states that the enactment of this bill is not expected to have an inflationary impact on prices and costs in the operation of the national economy.

V. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3 of Rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (new matter is printed in italics, existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1954

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Subtitle A—Income Taxes

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CHAPTER 1—NORMAL TAXES AND SURTAXES

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Subchapter D—Deferred Compensation, Etc.

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PART I—PENSION, PROFIT-SHARING, STOCK BONUS PLANS, ETC.

Subpart A—General Rule

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SEC. 401. QUALIFIED PENSION, PROFIT-SHARING, AND STOCK BONUS PLANS.

(a) REQUIREMENTS FOR QUALIFICATION.—* * *

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(k) CASH OR DEFERRED ARRANGEMENTS; *QUALIFIED MONEY PURCHASE PENSION PLAN.*—

(1) GENERAL RULE.—A profit-sharing or stock bonus plan shall not be considered as not satisfying the requirements of subsection (a) merely because the plan includes a qualified cash or deferred arrangement. *A money purchase pension plan shall not be considered as not satisfying the requirements of subsection (a) merely because the plan includes a qualified salary reduction arrangement.*

(2) QUALIFIED CASH OR DEFERRED ARRANGEMENT.—A qualified cash or deferred arrangement is any arrangement which is part of a profit-sharing or stock bonus plan which meets the requirements of subsection (a)—

(A) under which a covered employee may elect to have the employer make payments as contributions to a trust under the plan on behalf of the employee, or to the employee directly in cash;

(B) under which amounts held by the trust which are attributable to employer contributions made pursuant to the employee's election may not be distributable to participants or other beneficiaries earlier than upon retirement, death, disability, or separation from service, hardship or the attainment of age 59½, and will not be distributable merely by reason of the completion of a stated period of participation or the lapse of a fixed number of years; and

(C) which provides that an employee's right to his accrued benefit derived from employer contributions made to the trust pursuant to his election are [is] nonforfeitable.

(3) APPLICATION OF PARTICIPATION AND DISCRIMINATION STANDARDS.—

(A) A qualified cash or deferred arrangement *under a profit-sharing or stock bonus plan, or a qualified salary reduction arrangement under a money purchase pension plan,* shall be considered to satisfy the requirements of subsection (a)(4), with respect to the amount of contributions, and of subparagraph (B) of section 410(b)(1) for a plan year if those employees eligible to benefit under the plan satisfy the provisions of subparagraph (A) or (B) of section 410(b)(1) and if the actual deferral percentage for highly

compensated employees (as defined in paragraph (4)) for such plan year bears a relationship to the actual deferral percentage for all other eligible employees for such plan year which meets either of the following tests:

(i) The actual deferral percentage for the group of highly compensated employees is not more than the actual deferral percentage of all other eligible employees multiplied by 1.5.

(ii) The excess of the actual deferral percentage for the group of highly compensated employees over that of all other eligible employees is not more than 3 percentage points, and the actual deferral percentage for the group of highly compensated employees is not more than the actual deferral percentage of all other eligible emloyees multiplied by 2.5.

(B) For purposes of subparagraph (A), the actual deferral percentage for a specified group of employees for a plan year shall be the average of the ratios (calculated separately for each employee in such group) of—

(i) the amount of employer contributions actually paid over to the trust on behalf of each such employee for such plan year, to

(ii) the employee's compensation for such plan year. For purposes of the preceding sentence, the compensation of any employee for a plan year shall be the amount of his compensation which is taken into account under the plan in calculating the contribution which may be made on his behalf for such plan year.

(4) HIGHLY COMPENSATED EMPLOYEE.—For purposes of this subsection, the term "highly compensated employee" means any employee who is more highly compensated than two-thirds of all eligible employees, taking into account only compensation which is considered in applying paragraph (3).

(5) QUALIFIED SALARY REDUCTION ARRANGEMENT.—

(A) IN GENERAL.—A qualified salary reduction arrangement is an arrangement, under a money purchase pension plan—

(i) under which a covered employee may elect to have the employer make payments as contributions to a trust under the plan on behalf of the employee, or to the employee directly in cash, and

(ii) which provides that an employee's right to his accrued benefit derived from employer contributions made to the trust pursuant to his election is nonforfeitable.

(B) MONEY PURCHASE PENSION PLAN.—For purposes of this subsection, the term "money purchase pension plan" means a pension plan—

(i) which is a defined contribution plan (as defined in section 414(i)),

(ii) which was in existence on June 27, 1974, and which, on that date, included a salary reduction arrangement, and

(iii) under which neither the employee contributions nor the employer contributions may exceed the levels provided for by the contribution formula in effect under the plan on that date.

SEC. 402. TAXABILITY OF BENEFICIARY OF EMPLOYEES' TRUST.

(a) TAXABILITY OF BENEFICIARY OF EXEMPT TRUST.—

(1) GENERAL RULE. * * *

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(8) CASH OR DEFERRED ARRANGEMENTS; *QUALIFIED MONEY PURCHASE PENSION PLAN.*—For purposes of this title, contributions made by an empoyer on behalf of an employee to a trust which is a part of a qualified cash or deferred arrangement (as defined in section 401(k)(2) , *or a qualified salary reduction arrangement under a money purchase pension plan (as defined in section 401(k)(5)),* shall not be treated as distributed or made available to the employee nor as contributions made to the trust by the employee merely because the arrangement includes provisions under which the employee has an election whether the contribution will be made to the trust or received by the employee in cash.

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